

States” does not include the effecting of transactions in the United States in commodities (including hedging transactions) through a resident broker, commission agent, custodian, or other independent agent if (i) the commodities are of a kind customarily dealt in on an organized commodity exchange, such as a grain futures or a cotton futures market, (ii) the transaction is of a kind customarily consummated at such place, and (iii) the taxpayer at no time during the taxable year has an office or other fixed place of business in the United States through which, or by the direction of which, the transactions in commodities are effected. The volume of commodity transactions effected during the taxable year shall not be taken into account in determining under this subparagraph whether the taxpayer is engaged in trade or business in the United States.

(2) *Trading for taxpayer's own account*—(i) *In general.* The term “engaged in trade or business within the United States” does not include the effecting of transactions in the United States in commodities (including hedging transactions) for the taxpayer's own account if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the transaction is of a kind customarily consummated at such place. This rule shall apply irrespective of whether such transactions are effected by or through—

(a) The taxpayer himself while present in the United States,

(b) Employees of the taxpayer, whether or not such employees are present in the United States while effecting the transactions, or

(c) A broker, commission, agent, custodian, or other agent of the taxpayer, whether or not such agent while effecting the transactions is (1) dependent or independent, or (2) resident, non-resident, or present, in the United States, and irrespective of whether any such employee or agent has discretionary authority to make decisions in effecting such transactions. The volume of commodity transactions effected during the taxable year shall not be taken into account in determining under this subparagraph whether the taxpayer is engaged in trade or busi-

ness within the United States. This subparagraph shall not apply to the effecting of transactions in the United States for the account of a dealer in commodities.

(ii) *Partnerships.* A nonresident alien individual, foreign partnership, foreign estate, foreign trust, or foreign corporation shall not be considered to be engaged in trade or business within the United States solely because such person is a member of a partnership (whether domestic or foreign) which, pursuant to discretionary authority granted to such partnership by such person, effects transactions in the United States in commodities for the partnership's account or solely because an employee of such partnership, or a broker, commission agent, custodian, or other agent, pursuant to discretionary authority granted by such partnership, effects transactions in the United States in commodities for the account of such partnership. This subdivision shall not apply to any member of a partnership which is a dealer in commodities.

(iii) *Illustration.* The application of this subparagraph may be illustrated by the following example:

Example. Foreign corporation X, a calendar year taxpayer, is engaged as a merchant in the business of purchasing grain in South America and selling such cash grain outside the United States under long-term contracts for delivery in foreign countries. Foreign corporation X consummates a sale of 100,000 bushels of cash grain in February 1967 for July delivery to Sweden. Because foreign corporation X does not actually own such grain at the time of the sales transaction, such corporation buys as a hedge a July “futures contract” for delivery of 100,000 bushels of grain, in order to protect itself from loss by reason of a possible rise in the price of grain between February and July. The “futures contract” is ordered through domestic corporation Y, a futures commission merchant registered under the Commodity Exchange Act. Foreign corporation X is not engaged in trade or business within the United States during 1967 solely by reason of its effecting of such futures contract for its own account through domestic corporation Y.

(3) *Definition of commodity.* For purposes of section 864(b)(2)(B) and this paragraph the term “commodities” does not include goods or merchandise in the ordinary channels of commerce.

(e) *Other rules.* The fact that a person is not determined by reason of this section to be not engaged in trade or business with the United States is not to be considered a determination that such person is engaged in trade or business within the United States. Whether or not such person is engaged in trade or business within the United States shall be determined on the basis of the facts and circumstances in each case. For other rules relating to the determination of whether a taxpayer is engaged in trade or business in the United States see section 875 and the regulations thereunder.

(f) *Effective date.* The provisions of this section shall apply only in the case of taxable years beginning after December 31, 1966.

[T.D. 6948, 33 FR 5090, Mar. 28, 1968, as amended by T.D. 7378, 40 FR 45435, Oct. 2, 1975]

§ 1.864-3 Rules for determining income effectively connected with U.S. business of nonresident aliens or foreign corporations.

(a) *In general.* For purposes of the Internal Revenue Code, in the case of a nonresident alien individual or a foreign corporation that is engaged in a trade or business in the United States at any time during the taxable year, the rules set forth in §§ 1.864-4 through 1.864-7 and this section shall apply in determining whether income, gain, or loss shall be treated as effectively connected for a taxable year beginning after December 31, 1966, with the conduct of a trade or business in the United States. Except as provided in sections 871 (c) and (d) and 882 (d) and (e), and the regulations thereunder, in the case of a nonresident alien individual or a foreign corporation that is at no time during the taxable year engaged in a trade or business in the United States, no income, gain, or loss shall be treated as effectively connected for the taxable year with the conduct of a trade or business in the United States. The general rule prescribed by the preceding sentence shall apply even though the income, gain, or loss would have been treated as effectively connected with the conduct of a trade or business in the United States if such income or gain had been received or accrued, or such loss had been

sustained, in an earlier taxable year when the taxpayer was engaged in a trade or business in the United States. In applying §§ 1.864-4 through 1.864-7 and this section, the determination whether an item of income, gain, or loss is effectively connected with the conduct of a trade or business in the United States shall not be controlled by any administrative, judicial, or other interpretation made under the laws of any foreign country.

(b) *Illustrations.* The application of this section may be illustrated by the following examples:

Example 1. During 1967 foreign corporation N, which uses the calendar year as the taxable year, is engaged in the business of purchasing and selling household equipment on the installment plan. During 1967 N is engaged in business in the United States by reason of the sales activities it carries on in the United States for the purpose of selling therein some of the equipment which it has purchased. During 1967 N receives installment payments of \$800,000 on sales it makes that year in the United States, and the income from sources within the United States for 1967 attributable to such payments is \$200,000. By reason of section 864(c)(3) and paragraph (b) of § 1.864-4 this income of \$200,000 is effectively connected for 1967 with the conduct of a trade or business in the United States by N. In December of 1967, N discontinues its efforts to make any further sales of household equipment in the United States, and at no time during 1968 is N engaged in a trade or business in the United States. During 1968 N receives installment payments of \$500,000 on the sales it made in the United States during 1967, and the income from sources within the United States for 1968 attributable to such payments is \$125,000. By reason of section 864(c)(1)(B) and this section, this income of \$125,000 is not effectively connected for 1968 with the conduct of a trade or business in the United States by N, even though such amount, if it had been received by N during 1967, would have been effectively connected for 1967 with the conduct of a trade or business in the United States by that corporation.

Example 2. R, a foreign holding company, owns all of the voting stock in five corporations, two of which are domestic corporations. All of the subsidiary corporations are engaged in the active conduct of a trade or business. R has an office in the United States where its chief executive officer, who is also the chief executive officer of one of the domestic corporations, spends a substantial portion of the taxable year supervising R's investment in its operating subsidiaries and performing his function as chief executive